Presenting The New American Family Business, Page 71

THE MAGAZINE FOR
GROWING COMPANIES

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Inc.®

THE TAKE AT THE TOP

INC.'S ANNUAL COMPENSATION SURVEY

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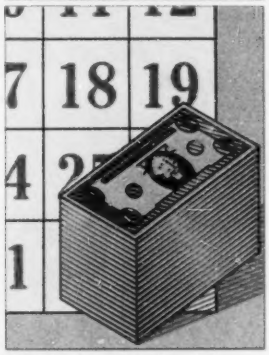

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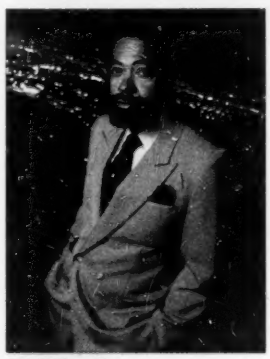

81 Blacks
Why blacks aren't starting businesses

COVER ILLUSTRATIONS
by
Nigel Holmes

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OFFICERS AND GENTLEMEN

Venture Money Flows Into Defense Start-ups

VENTURE CAPITALISTS USED to approach defense-related deals with all the enthusiasm a recruit musters for reveille on Parris Island. They didn't want to fool around with security clearances, and they weren't well connected with the defense world. "Venture capital funds didn't even look at companies doing business with the Defense Department," says C. W. Harvey, a special partner in New Enterprise Associates (NEA).

ED YOUNG

American Advance Ventures partner Phil Gioia
New companies capitalize on Reagan arms buildup.

That's not true anymore. With their computer investments faltering, many venture capitalists are looking for better returns in specialty retailing, factory automation, and other fields. Now a few are investing in defense-related companies, too. Some are Vietnam veterans who have acquired M.B.A.s and finance experience and are taking advantage of their military contacts. Others are capitalizing on the Reagan arms buildup, and see a favorable climate ahead for defense-related public offerings. And it doesn't hurt that the Pentagon, in effect, offers working capital to small companies in the form of progress payments on military contracts.

NEA started a defense venture fund, Spectra Enterprise Associates, after discovering that its eight defense-related investments were more successful than any other category. The fund, which is raising up to $25 million, will invest in small defense firms, especially those involved in electronic warfare. During its first nine months of fund-raising, says Harvey, Spectra "went through 66 potential deals without looking for them."

Another new fund, American Advance Ventures, has looked at even more investment opportunities—at least 430 unsolicited plans in its first 11 months—and the firm hasn't even closed its financing yet. Unlike Spectra, AAV plans to invest primarily in companies applying military aerospace and electronics technology to *commercial* markets. One promising area is improved flight instrumentation. "We can put a footprint down in both sectors. A company that we back may very well be selling into the defense side and the commercial side at the same time," says partner Phil Gioia, whose experience includes 10 years as an Army officer, as well as more conventional stints at investment banks and larger venture firms.

—Virginia I. Postrel

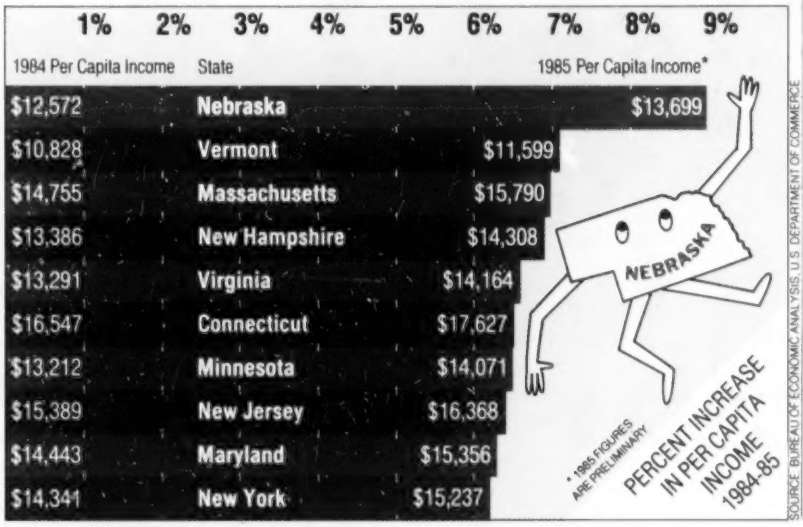
SCORECARD

MORE MONEY TO SPEND

Which state posted the biggest jump in per capita income from 1984 to 1985? Hint: much of the rise came from federal handouts—and we're not talking food stamps here.

Give yourself 10 points if you guessed Nebraska. Federal farm subsidies are pulling the Cornhusker economy up after a long slide, and the ripple effect is helping such nonfarm industries as construction. "The whole state economy started to go downhill around 1979 and '80, and things are just starting to perk up a little bit," says Charles Bare, research associate at the University of Nebraska's Bureau of Business Research.

Two other great beneficiaries of federal largess—Maryland and Virginia—also made the list. The leading region was New England, whose booming economy boosted 4 of its 6 states onto the top 10. *—V.I.P.*



NIGEL HOLMES

DWINDLING OPTIONS

Accounting Rule May Squelch Stock Plans

IN APRIL, VICOM SYSTEMS INC. extended its stock option plan to include about half of its 75 employees. The company never dreamed that a change in accounting rules might make it regret the move.

But like many other small companies, Vicom may face a tough choice this fall: it can continue to issue stock options and take a painful hit on its earnings—or it can cut back on options and find it harder to recruit the best employees, who are often lured by the prospect of getting a piece of the action. "Now we have to start looking at different types of incentives," says Connie Osborne, chief financial officer of the maker of image-enhancing computers. "Or we simply may not be able to attract or retain the executives we want."

The Financial Accounting Standards Board (FASB) is expected this year to propose that the value of stock options be charged against earnings. The only major effect of options now is to dilute existing shares. The group, whose rulings are usually adopted by the Securities and Exchange Commission, argues that options have value and should be treated like other long-term compensation. The board is trying to devise a formula that would help guide investment bankers to measure the stock's value. The complicated method would probably use market price, exercise price, and any

THE TAKE AT THE TOP

INC.'S ANNUAL COMPENSATION SURVEY

How small companies reward their key executives.

BY PATRICIA AMEND

THIS PAST YEAR MAY HAVE WITnessed the final triumph over inflation, as some contend, but that has not stopped chief executive officers of small companies from giving themselves huge increases in compensation. In all fairness, other top officers didn't do so badly either in 1985, though they didn't reach the average 25% increase in salary and bonuses claimed by CEOs. To put the raise in perspective, consider that inflation in 1985 was close to 4%; compare that with five years earlier, when, with inflation over 13%, CEOs gave themselves a paltry 18% increase. As for benefits in 1985, there was a move toward adding programs geared to performance—long- and short-term incentive plans, special awards, and performance appraisal systems—while reducing more traditional programs, such as health and retirement benefits.

These are some of the conclusions to be drawn from INC.'s eighth annual compensation survey, a summary of questionnaires sent to a random sample of INC. subscribers. The 853 responses came mostly from private companies that range in size from start-ups with one employee and $2,000 in sales, to 40-year-old companies with thousands of employees and revenues of more than $1 billion. On average, the companies surveyed have 119 employees and sales of $12.6 million, but those figures are a little misleading, due to the presence of a handful of very large companies. Looking at median size rather than average, the typical company has 19.5 employees and $1.7 million in sales.

As for the typical founder and CEO, he is 45 years old, has 11 years with the company, and takes a salary of $71,000. If he pays himself a bonus, and over half do, he'll pocket another $35,000. The chief operating officer, chief financial officer, and chief marketing officer fall just below the CEO in age (they're in their early forties) and in years with the company (7 to 8, on average). Among the three, the COO fares best in salary, bonus, and increases over last year. Ironically, the guy who handles the money, the CFO, gets paid the least.

Figuring out what and how to pay people, especially key employees, is still one of the greatest challenges of running a small company, but it's only one of many. So it is not surprising that most companies in the survey have no formal compensation plans at all. Most use no base salary ranges or any kind of a formal performance appraisal system. Even bonuses are apt to be discretionary and paid at such traditional times as Christmas or year end. But that's not to say that these companies aren't interested in alternative forms of compensation.

Tom Hackett, for example, CEO of Advantage Business Services Inc., a $2.5-million payroll check processor in Auburn, Maine, is working on a cost-tracking system that he can use to set performance bonuses for 15 or 20 of his middle managers. And Charles Chauncey, CEO of LCC Graphics Inc., a $5-million Amherst, N.Y., lithographic prepress service, is looking for a special compensation program that will motivate his hourly workers to keep to the high standards demanded by his quality-concerned customers. What he has in mind is some sort of flexible "payroll pool" with a "little bit of a cushion" that would also protect his bottom line from the sporadic workloads inherent to his business. (It's not that Chauncey hasn't experimented already. He once had a profit-sharing plan, but threw it out because he discovered that a once-a-year check wasn't motivating anybody.) Chauncey also dreams of a new incentive plan for his salespeople. The commission plan he has now, it turns out, is working against the company by encouraging salespeople to sell higher-priced weekend work, a time when the plant is already going full steam with the rush jobs common to the printing business.

The typical executives

Profiles of the top four officers based on survey averages

	CEO	COO	CFO	CMO
Total compensation	$90,362	$69,743	$52,773	$59,799
Base salary	$71,134	$55,803	$45,317	$50,356
Percentage receiving bonus	56%	65%	54%	62%
Bonus as a percentage of base salary	50%	35%	29%	34%
Percentage change in total compensation 1984–85	+25%	+23%	+20%	+17%
Age	45	41	42	41
Years with company	11	8	8	7
Percentage who are also founders	69%	—	—	—
Average equity position	67%	27%	27%	17%

The typical company

A profile based on survey averages

Total revenues	$12,645,000
Employees	119
1985 payroll	$1,741,000
Payroll as a percentage of revenues	13.8%
Percentage that are privately owned	92%

Executive benefits and perks

What benefits and perquisites companies provided top officers

	CEO	COO	CFO	CMO
Company car & expenses	81%	70%	58%	72%
Supplemental life insurance*	74	69	66	61
Supplemental medical insurance*	52	51	52	46
Tax return preparation	51	34	29	21
Club dues & expenses	48	33	27	29
Personal tax & financial planning	34	25	22	16
Annual physical examination	31	27	30	27
Low- or no-interest loan	26	21	17	17
Supplemental retirement benefits*	22	23	22	20
Deferred compensation	17	15	16	17
First-class air travel	14	9	8	9

*Beyond customary companywide benefits

Companies in the survey found the setting of pay levels to be their most difficult compensation problem; their second most difficult problem was figuring out appropriate long-term incentives or equity-participation plans. Mike Nebel, CEO of Vycor Corp., might well put that at the top of his list. Nebel has spent the past four years building up his facility-management firm in Washington, D.C. Now all the computer equipment is in place, the software is ready, some prime government work has been contracted—and Mike expects to go national fast. What he needs are some long-term incentives to attract top management talent. He is considering giving equity participation, but he is still evaluating the long-term impact on the company.

Evidently, many CEOs are toying with one compensation idea or another. But a few have gone far beyond that stage—and they have the results to show for it. Frankie Rich, for one, has developed an elaborate bonus plan, not just for top officers, but for all 49 salaried employees at Action Equipment Co., a $15-million Londonderry, N.H., distributor of light construction equipment. Rich, who once worked for an employer who didn't show any appreciation, "wants people to feel valued here." And so they do. Action Equipment distributes most of its pretax profit to employees each year who then give it back to the company in the form of a two-year "loan." The loan, plus interest, is paid back to employees every week in the form of a second paycheck. Rich's scheme raises a lot of questions: Wouldn't it be smarter to put the money back into the company? Isn't it risky to tie up the company's future cash? Maybe so, but you couldn't tell it by the numbers. Action Equipment, #18 on the INC. 500 list of America's fastest-growing private companies this past year, had a 7,013% gain in sales from its founding in 1980 through 1984.

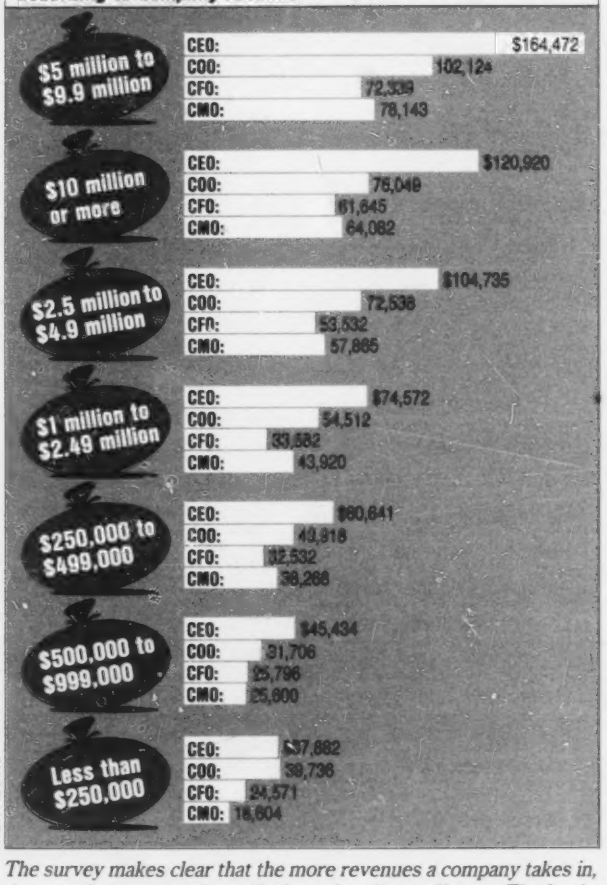
Dynamark Securities Center Inc., with a 1,301% growth in revenues during the same period and placing #165 on the INC. 500 list, also came up with an unusual incentive plan. The firm, a distributor of home security systems in Hagerstown, Md., had a thorny problem to solve. Dynamark is made up of two recently merged companies, and is run by all four original owners. To keep things working smoothly, says chairman Ed Cusick, they had to devise a system that would satisfy all four egos. "Compensation for key people," Cusick says, "is based entirely on the contribution that the area they manage makes to overall corporate goals. It's not tied directly to profits, because it may not be one department's fault that another department fell off." He adds, "We've been able to attract the players into this merger because they have [what amounts to] the entrepreneurial freedom to run a company of their own."

As for the future, the average CEO in the survey expects to give 12% salary raises to his top officers this year. Bonuses, more apt to be discretionary, are harder to predict. Many, however, will be based on sales and profit goals, and here our CEOs are an optimistic bunch. More than a quarter say they expect sales will increase by 21% or more for fiscal '86. If a common thread runs through the INC. survey, it is that most of the companies do look to the future with optimism—and with the expectation of having the time and energy to try out new ideas. Close to half of the survey respondents said they were already thinking about future changes in compensation programs. A performance appraisal system was highest on their wish list of companywide plans, followed by annual incentive programs for all employees. Since almost a quarter of the companies had in fact made changes in their executive compensation programs this past year, there's every reason to believe they will act on their intentions. □

(charts continued on page 52)

EXECUTIVE COMPENSATION: by company revenue

How much the top four officers received in salary and bonus according to company revenue



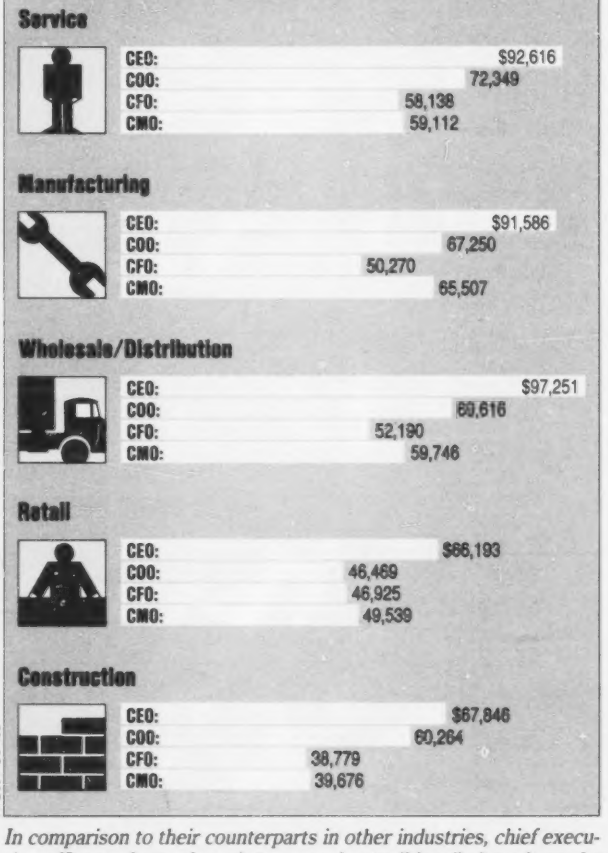
NIGEL HOLMES

The survey makes clear that the more revenues a company takes in, the more its top executives take home in salary and bonus. The fact is, the gap between the chief executive officers at the top and those at the bottom has widened over the past few years. In 1980, for example, CEOs of companies in the largest range—$10 million or more in revenues—paid themselves roughly three-and-a-half times as much as their counterparts in the smallest companies surveyed that year, those under $500,000. This year the multiple is close to four-and-a-half. But, as the CEO of a $1.2-million service firm in Michigan might tell you, averages are only averages. This CEO didn't take a salary at all the first year of his three-year-old business. Sometimes, to finance growth, he covered the payroll himself rather than borrow from his franchisor or the bank. Why the conservative approach? "Every business has its cycles," he says. "I don't want to be in a down cycle and owe the bank a ton of money. I want to build a business here."

Percentage of survey responses by company revenues: $10 million or more, 18%; $5 million to $9.9 million, 11%; $2.5 million to $4.9 million, 13%; $1 million to 2.49 million, 21%; $500,000 to $999,000, 14%; $250,000 to $499,000, 9%; under $250,000, 14%.

EXECUTIVE COMPENSATION: by industry

How much the top four officers received in salary and bonus in the five major industries



NIGEL HOLMES

In comparison to their counterparts in other industries, chief executive officers of manufacturing companies traditionally have been the highest paid, according to INC. *compensation surveys. This year they've been nudged out by CEOs in the wholesale/distribution business and by those in service. (For chief marketing officers, though, manufacturing still looks to be the best bet for earning a good salary and bonus.) The CEO of a $3.6-million manufacturing firm in Michigan may be representative of the times. He pays his COO $38,000, his CFO $32,000, and his CMO $33,000. His own take? Zero. When you own 90% of a firm that's losing money or just breaking even, as he does, you lose. There's been a lot of publicity about the lower-paying service industry overtaking manufacturing in the United States. Judging from the* INC. *survey, however, service companies pay just fine, at least on the executive level. The CEO of a $26-million service firm in Virginia, for example, says he has no complaints with his $225,000 salary and $400,000 bonus.*

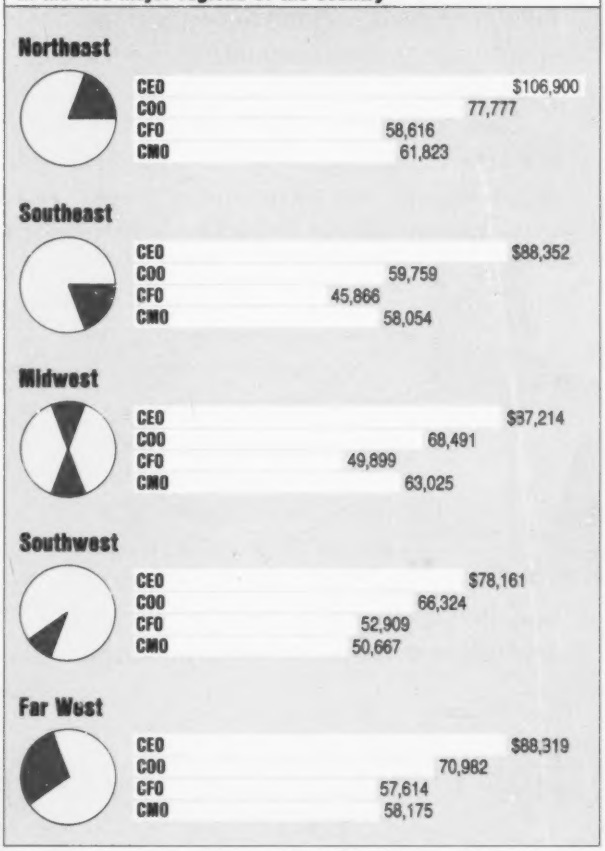
Percentage of survey responses by industry: service, 44%; manufacturing, 23%; wholesale/distribution, 14%; retail, 8%; construction, 6%; other, 5%.

THE FACTS BEHIND THE FIGURES

This is the eighth consecutive year that INC. has conducted an executive compensation survey. In late February, we mailed a four-page questionnaire covering executive salaries, benefits, bonuses, and policies to a random sample of nearly 23,000 subscribers. Data Tabulation Services Inc., of Stoneham, Mass., compiled the 853 returns under the direction of special projects editor Sara Baer-Sinnott. To expand on issues covered in the survey, INC. hosted a roundtable discussion in April. Among those attending the session were five of the chief executive officers who responded to the survey; Peter T. Chingos, practice director of Peat Marwick Mitchell & Co.'s Executive Compensation and Personnel Consulting division; and Bruce Hanson, a Boston-based compensation expert with Towers, Perrin,

EXECUTIVE COMPENSATION: by region

How much the top four officers received in salary and bonus in the five major regions of the country



NIGEL HOLMES

Top executives of private companies do best in salary and bonus in the Northeast. That fits right in with the stereotype of the region as wall-to-wall factories. And how do other regions fit their stereotypes? Well, the Midwest brings to mind farms and factories; the West and Southwest, high tech and lots of space; the Southeast, textiles and more agriculture. But look closer, and you'll find some surprises. Consider one Alabama magazine publisher who responded to the survey. With a healthy $17.2 million in sales, this CEO pays himself $240,000 in salary and a $120,000 bonus to boot. That's more than four times the average for the Southeast. Then there's the CEO of a $42-million Salt Lake City retail operation who paid himself $100,000 each in salary and bonus. That made his take more than twice the average for his region. And even though Texas has been having problems lately, one Dallas electronics manufacturer isn't hurting too badly. The CEO of this $26-million company reports giving himself a $256,000 salary and a $90,000 bonus, nearly four-and-a-half times the region's average. So much for stereotypes.

Percentage of survey responses by region: Northeast, 22%; Southeast, 14%; Midwest 34%; Southwest, 11%; Far West, 19%.

Forster & Crosby, a management consultant firm.

Complete results of the survey, in which the confidentiality of all responses is protected, are available. To obtain a copy, send a written request and a check for $65 to INC. Executive Compensation Study, Attn: John Titus, 38 Commercial Wharf, Boston, MA 02110, or call (800) 372-0018. In Massachusetts, call (617) 227-4700.

The executive bonus

How companies provided bonuses to top officers

Companies paying bonuses	78%
Type of bonus*	
Cash	99%
Stock	7%
Other	2%
Basis for allocation of bonuses*	
Discretionary	56%
Achievement of sales goals	21%
Achievement of profit goals	32%
Percentage of sales	6%
Percentage of profits	25%
Return on equity/assets/sales	8%
Companies with a bonus pool	25%
Basis for establishing bonus pool*	
Discretionary	39%
By a fixed formula	36%
By a formula set annually	25%

*Totals may exceed 100% because of multiple responses.

Changes in executive compensation policies

What programs companies added or cut this year

Percentage of companies that made changes	22%	
	Added	Cut
Short-term incentive plan	42%	30%
Long-term incentive plan	25	13
Health/retirement benefits	29	44
Perquisites	13	26
Special recognition/awards	24	9
Performance appraisal system	33	4

The most difficult issues

What compensation questions were found to be of greatest concern, in order of difficulty

1. Determining worth of job; setting pay levels
2. Determining appropriate long-term incentives or equity participation plans
3. Developing annual incentives/bonuses
4. Controlling benefit costs
*5. Keeping abreast of tax law changes (developing tax-effective compensation plans)
*5. Obtaining competitive compensation information

*Tied for least concern

THE TAKE AT THE TOP

PAY FOR PROFITS

How the most competitive companies around are "incentivizing" their compensation systems.

BY BRUCE G. POSNER

BACK IN THE LATE 1960s, SHANNON & Luchs Co. was just one of a dozen or so small real estate brokerage businesses in Washington, D.C. Its managers were all paid in accordance with the norms of the industry, and they received the standard merit raises and bonuses at the end of each year. Then, around 1970, the company overhauled its executive compensation system. In addition to their regular salaries, division heads were given the opportunity to earn a percentage (10% to 25%) of the net profits of their respective divisions, adjusted for overhead and other expenses. The result: sales and profits took off. Today, Shannon & Luchs is one of the largest and most profitable real estate companies in the United States. Company president Foster Shannon gives full credit to the compensation system.

Such tales may sound too good to be true, but they are becoming increasingly common as more and more companies turn to incentive pay as a means of achieving strategic objectives. The trend is easily the hottest one to hit the compensation field since the cost-of-living raise. It involves a whole different approach to compensation, one that is geared toward achieving future objectives, rather than rewarding past performance. To date, thousands of businesses have adopted such systems, and those that try it swear by it. Most practitioners will tell you that—in addition to fostering phenomenal results—incentive compensation allows them to recognize the movers and shakers in their organizations, the people who make things happen, and to inject a new sense of vitality and purpose into the company as a whole.

Testimonials aside, the trend reflects important changes in the business environment. As inflation has declined, companies have found it harder to justify the big raises that were common in the 1970s and early '80s, and so they have begun searching for new ways to keep employees motivated. Even more important has been the pressure of increased competition, forcing companies to become ever more efficient and profitable.

Among the first to move in the direction of incentive compensation were the *Fortune* 500 companies. A study by Hewitt Associates, in Lincolnshire, Ill., shows that more than 90% of the nation's largest companies had short-term incentive plans as early as 1980. These plans made it possible for participating managers to earn bonuses totaling 16% to 55% of their base salaries, given the achievement of certain operating or financial targets. Since then, thousands of smaller businesses have set up incentive plans of their own.

On the surface, at least, creating an incentive-pay program doesn't appear to be difficult at all—provided you understand where your company is, and where you want it to be. You have to know, for instance, what you're shooting for, whether it's more profitability, higher sales, better service. As a wise man said, if you don't know where you're going, the odds are you'll wind up somewhere else.

Once you are clear about your objectives, however, the rest falls into place. First, you have to decide who to include in the plan. If you want to increase profitability, for example, and if your business is composed of relatively autonomous operating units or product areas, you may well decide to focus on a handful of key managers—the ones with the leverage to make sure their respective units make money. On the other hand, you may have a company like Riley Gear Inc., in North Tonawanda, N.Y., a $6-million manufacturer of precision gear systems, whose success depends on its ability to deliver quality products on time at competitive prices. Since every employee plays a role in achieving the company's productivity goals, all 90 of them receive a quarterly bonus check when targets are met.

Of course, you also have to choose the performance criteria by which you'll hold people accountable. Here, your decision is almost entirely a function of your goals. Indeed, two identical companies might deliberately choose different performance criteria. One, for example, might decide to reward nothing but sales growth as a way to spur aggressive selling, while the other might target profits or quality control. The latter business would, in effect, be telling people to say no to some business opportunities. But each company, in its own way, would be encouraging the kind of behavior it wanted.

Then again, some companies might want their employees to pay attention to more than one goal at a time. For several years, Nicolet Instrument Corp., a Madison, Wis., manufacturer of medical and chemical testing equipment, calculated its management bonuses using a formula that took into account both sales growth and return on assets. With two important goals to balance, says chief executive officer and president John Krauss, there were no rewards for leaning too far in one direction. Other companies accomplish the same thing by establishing separate incentive pools tied to the achievement of different objectives.

Whatever measures you choose, they must be readily comprehensible to the employees they affect. If employees don't know what kind of performance you are trying to encourage—or why it's important—they aren't likely to respond as you intend. You either have to explain what you are trying to accomplish, or choose other measures. By the same token, the performance criteria must involve aspects of the business that the affected employees can control and monitor. That means providing them with the data—monthly sales figures, production reports, profit statements—that will show them how they are doing.

Within these parameters, however, you have a lot of flexibility, not to mention influence. You can, indeed, attach incentives to almost anything—and thereby determine how managers and employees spend their time and where they focus their attention.

Now, none of this seems particularly difficult. You choose your goals, your people, your performance criteria. What could be simpler? Well, not so fast. The problem is that, at every stage, you have decisions and judgments to make, and any one of them can undermine your plan.

Consider, for example, the choice of performance criteria. Should you establish custom-made targets for individuals, or is it better to tie their incentives to the performance of the company as a whole? Dynamark Security Centers Inc., a $5.5-million franchisor of home security centers and distributor of security equipment, gives

THE INDIVIDUAL INCENTIVE
Tailoring the bonus to the job

ROSEMARIE CERTO

Michael Zisman
President of Soft-Switch Inc.

Establishing incentives for individuals takes time, and many jobs are difficult to measure. But Michael Zisman, chairman and chief executive officer of Soft-Switch Inc., in King of Prussia, Pa., thinks that individual incentives are critical to the success of any compensation program. Last year, his company, an $8-million maker of computer networking software, embarked on a program that provides special rewards for about one-third of Soft-Switch's 70 employees.

The idea, says Zisman, was to encourage key employees to focus on individual objectives that are important to the overall success of the business. To provide the necessary rewards, Soft-Switch established a bonus pool based on its achievement of certain sales and profit targets. If the targets are met in fiscal 1987, for instance, the company will kick in 20% of the combined base salaries of affected employees. How that money gets divided depends partly on each individual's contribution to the company's collective success. Last year, for example, half of the potential bonus for the vice-president of operations was tied to such things as improving customer satisfaction ratings and reducing the time required to install products. (The other half was tied to the overall performance of the business.) Similar criteria are applied to many nonline positions as well. A large chunk of the controller's bonus, for instance, is linked to getting monthly reports in on time.

Zisman admits that it's not always easy to define the right objectives for jobs, but he argues that, without individual goals, some critical tasks will never become priorities. What's more, you'll always have a hard time differentiating between levels of performance, and everyone will wind up with roughly similar rewards.

THE GROUP INCENTIVE
Rewarding a company as a team

PHIL MATT

Tom Lowry
President of Riley Gear Inc.

Suppose you had a company in which each and every employee had the power to undermine your competitive position. That was the problem at Riley Gear Inc., a maker of precision gears, in North Tonawanda, N.Y. The solution was to create a compensation system that gives all 75 manufacturing people and the 15 other employees a significant financial stake in the overall success of the company.

The system is known as gain-sharing, and it is built around monthly productivity targets. Every order that comes in to the $6-million business is broken down into a series of production steps, which are assigned hourly rates related to the capabilities of the equipment and the complexity of the work. These rates are then used to create a "blended" productivity target for the company. The amount that Riley puts into the bonus pool each month depends entirely on the achievement of the companywide target, which in turn depends on the workers meeting, or exceeding, their goals.

In the two years the system has been in effect, Riley's hourly workers have earned 3% to 4% a year in extra compensation—over and above the annual increases of 3.3% provided in their three-year union contract. President Tom Lowry thinks that bonuses of 8% to 10% a year are well within reach "as long as the productivity is there." He's also talking about adding nonfinancial rewards, such as extra vacation time.

Of course, there are trade-offs involved in paying plantwide bonuses. "If you have superb performers, you can't really recognize them," Lowry notes. Nevertheless, he believes the benefits of the system outweigh its liabilities. "There's a lot of peer pressure. People know that if we get the cost reductions, everyone gets something. And they understand it's a competitive market, and we're all in this together."

each of its nine key managers and supervisors a different set of performance targets. The marketing and training manager, for instance, gets a small slice (about 1%) of sales up to a given level, and a smaller percentage after that. The head of franchise development, on the other hand, gets a cut of the franchise fees and the inventory ordered by new franchisees. "The structure of the deals is basically the same," says chairman Ed Cusick, "but everyone gets his own report card."

Some businesses go even further, linking an individual's reward to the accomplishment of specific tasks. Thus, at Morris Decision Systems Inc., a computer dealership and maintenance company in New York City, the vice-president of finance has to get a new general-ledger system up and running in order to earn a part of his bonus for 1986.

But there can be problems with this approach. First, it takes time and effort to select the right goals. Then there is the administrative burden of monitoring the performance of many individuals. But perhaps most worrisome is the possibility that what's good for a particular individual, or group of individuals, may be awful for the business as a whole.

In the early '70s, for instance, Nypro Inc., now a $65-million plastic injection molding company in Clinton, Mass., began to reward employees for their own individual output. Some enterprising workers found ways to speed up production equipment during their shifts. They refused to share their secrets with their colleagues, however, and the high-speed work undermined quality. So Nypro was forced to switched from individual to group incentives.

Fearing similar problems, many companies require a certain level of overall results before individual bonuses are paid. "You can say, if we earn so many dollars, or if we get into the World Series, you'll get a reward," notes Peter T. Chingos, who heads the compensation consulting practice at Peat, Marwick, Mitchell & Co. But finding the right balance is not easy.

Nor is it easy to establish performance standards for every job. True, you can set quotas for salespeople and determine efficiency ratios for plant managers. You can even measure performance in such areas as quality control: at Soft-Switch Inc., a King of Prussia, Pa., software company, the quality-control manager is rewarded in part on the basis of results from customer-satisfaction surveys. But what do you do with a human-resources manager? Should you measure employee turnover? In many cases, turnover is totally beyond a manager's control. What's more, if you *do* target turnover, you run the risk of winding up with unambitious employees whose main virtue is that they don't like to change jobs.

To avoid these sorts of decisions, many CEOs prefer to maintain a certain amount of discretion over bonuses. In rewarding vice-presidents and project managers, Joseph Viar takes into account the "degree of difficulty" of the projects they manage. He could pay strictly on the basis of volume of business under management, "but different jobs rely on different mixes of inside people, consultants, and subcontractors," says Viar, president of Viar & Co., an Alexandria, Va.-based consulting company in the data-processing area. Thus they require different amounts of management, and he compensates accordingly.

Then again, you can't use too much

THE PHANTOM STOCK INCENTIVE
Eating your cake and having it, too

TOM SIMON

Al Weatherhead
Weatherchem's founder and CEO

How does a private company get key employees to lose sleep over the business without giving up equity? That was the question confronting Weatherchem Inc., a $6.5-million maker of plastic caps and closures located in Twinsburg, Ohio. Its solution: "phantom stock," an increasingly common technique by which a company rewards employees for building the business's value, while keeping the stock in the original owner's hands.

As founder and chief executive officer of the family-owned company, Al Weatherhead knew he wanted to institute some kind of long-term reward system to get his half-dozen key managers focused on "profitable growth." Real equity made him nervous, however. Among other things, he didn't know how long the key people would stay around the 65-employee company, and he didn't look forward to endless battles over stock valuation. Under the phantom program, adopted in May 1982, selected managers will receive a share of the amount by which Weatherchem's value appreciates over a five-year period. The value is calculated according to a formula that takes into account the company's return on assets and return on equity, both adjusted for its cost of capital.

The plan has encouraged managers to focus on Weatherchem's long- and short-term objectives, but Weatherhead is dissatisfied with the formula. "It's too damn complicated, and it isn't something you can pound the table over." So the company is formulating a new, simpler phantom plan to take effect when the first one expires next May. The new formula, he says, will probably be based on cumulative profits over a three-year period. Why three years this time, instead of the five years in the original plan? "Five years," Weatherhead offers, "just seemed a bit too long."

THE REAL EQUITY INCENTIVE
When nothing else will do

RICHARD HOWARD

G. B. Lankton
Nypro's CEO and president

Few owners of small companies relish the idea of taking on their employees as partners and minority shareholders, but that was not the case with Gordon B. Lankton, president and chief executive officer of Nypro Inc., a highly successful plastic injection-molding company in Clinton, Mass. He inaugurated the company's unusual stock bonus program 17 years ago, and he has never regretted the decision.

Created in 1969, when Nypro was a struggling $4-million business, the plan was designed to encourage employee commitment and achievement by making equity available to people throughout the company. Eligibility is based on a formula that takes into account three factors: length of service, salary level, and job performance. Every year, employees receive points in each category. If an individual scores 20 points or better, he or she can receive a special equity bonus.

The equity takes the form of real stock. The program is not an employee stock ownership plan and uses none of the tax advantages associated with ESOPs. Nor does Lankton view phantom equity as a viable alternative in a company like his. "I want [the stock] to feel real," he says. "You can explain phantom stock to people who are financially sophisticated, but it can be incredibly confusing to everyone else."

As Nypro has grown—today, it is a $65-million company with 1,200 employees—some 90 employees, about half of them nonmanagers, have become shareholders. Meanwhile, the value of the stock (measured by book value) has shot from $3.50 a share in 1969 to $25 last year. To discourage employees from leaving, Nypro requires departing shareholders to sell their stock back to the company over a period of 5 to 10 years—thereby minimizing the impact on Nypro's cash flow.

discretion in awarding bonuses without undermining your incentive program. If the principal basis for compensation is the boss's whim, the only real incentive is to stay on his good side.

At this point, you still have to decide how much money you should dish out in the form of incentives. It can't be so much as to imperil the business—by getting in the way of meeting debt service payments, for example—yet it has to be enough to attract employees' attention. As a rule of thumb, most compensation experts advise that you make available incentive bonuses of at least 10% to 15% over base salaries. Employees will tend to regard smaller bonuses as "tips," which may motivate them to work a little harder and "smarter," but not enough to justify the effort and expense of establishing an elaborate incentive system.

Then there's the related issue of selecting the right performance levels—a critical part of the process. If the targets are too high, people may give up. If they're too low, you may encourage people to take it easy. What happens, for example, if you surpass the target midway through the year?

And what if you set target levels that inadvertently wind up *penalizing* your best employees? That's more or less what happened at The Myers Group Inc., a freight forwarder with 65 offices around the country. For several years, the company paid out bonuses according to a formula that rewarded people annually for profit improvements at their individual branches. The formula was designed to motivate those who worked at the least efficient locations, and that it did. But it provided little incentive for employees assigned to the most profitable branches. Moreover, the system became less and less effective over time. The better an office did one year, the harder it was to receive a bonus the next. People grumbled, and so the company, based in Rouses Point, N.Y., eventually scrapped the formula. Now incentives are tied to the overall profitability of each office and of the company.

Once you have settled on performance levels and criteria, you still have to decide how often people will be rewarded—an aspect of incentive compensation that is often overlooked. After all, the real test of any incentive program is its ability to keep people focused on company objectives. Annual bonuses are traditional, and relatively easy to administer, but can employees stay focused on targets for a whole year? Gordon Lankton of Nypro, the plastic molding company, doesn't think so. His company pays its productivity bonuses on a quarterly basis because "a year can feel like a long time," he says. To make sure that everyone notices, Nypro even uses special profit-sharing checks with a picture of George Washington in the center and "profit-sharing" printed across the top.

On the other hand, quarterly bonuses can be extremely impractical from a company's perspective. Not only does it take administrative effort, but it demands an ability to forecast with precision and to anticipate cash-flow needs. Recently, an air-freight company paid out substantial incentive bonuses at the end of one quarter, only to hit a dry period the next. It hastily revamped its quarterly incentive program. Now nonmanagers get bonus checks after each profitable quarter, but managers don't receive theirs until annual results are in.

So, if you look hard enough, there are solutions to all these potential problems. The bad news is that, once you've come up with a viable short-term incentive plan, you

STRATEGIES FOR INCENTIVE COMPENSATION

You can look outside for help and inspiration, but the answers are all close to home.

There are no real shortcuts to creating an effective incentive compensation system. No matter how you approach it, you still have to ask, and answer, dozens of difficult questions about your goals, your people, and your business. It helps, however, to have a strategy for dealing with these questions. There are essentially three to choose from:

THE COPYCAT METHOD

One strategy is to adapt somebody else's plan to your own circumstances and needs. It's particularly appealing if the other company is similar to yours, and if its system has worked well.

That was the case with Nicolet Instrument Corp., which developed its plan back in 1981 after chief executive officer John Krauss saw an article in the *Harvard Business Review* about the incentive compensation program at Analog Devices Inc. As it happened, Analog had management and operating structures strikingly similar to Nicolet's. So Krauss copied Analog's incentive compensation program, and it worked effectively for several years.

There are pitfalls in the copycat approach, however. To begin with, no two companies have identical cost structures: if your costs are higher than those of the company you're copying, you may be stimulating behavior that you can't afford. Nor can you assume that the other company's market position or goals are the same as yours. If they aren't, the performance criteria are liable to be off as well. "Copying another incentive plan," says one consultant, "is like trying to learn Jimmy Connors's backhand when you don't have his serve." It may work; then again, it may throw everything out of whack.

THE CONSULTANT ROUTE

Another strategy is to hire a specialist to design your compensation program for you. That's a natural impulse, and consultants do have much to offer in the way of advice and experience. But many have worked only with large companies, which does not help them in understanding and solving the compensation problems of smaller companies.

James Bernstein learned that lesson the hard way when he brought in a well-known consulting firm to design an incentive plan for his $4.5-million health risk–management firm, General Health Inc., based in Washington, D.C. He wanted a compensation system that would encourage employees to focus on sales volume and building market share. With that mandate, the consultant produced an elaborate plan under which all 80 employees could earn handsome bonuses by meeting individual and company objectives. "The consultant gave me his best advice," says Bernstein. "It sounded just terrific." Unfortunately, it wasn't. Not only did the system demand hours upon hours of management time to review each employee's objectives, but it also completely overlooked the company's need to change direction and shift people around on short notice. Objectives that made perfect sense one week were outdated the next.

Within a year, General Health scrapped the consultant's incentive program and installed a simpler one designed by Bernstein himself. Dispensing with individual goals for everyone but salespeople, the new system rewards employees for meeting quarterly profit objectives. It takes a lot less time to administer, notes Bernstein, and yet it's enough to send the message that "everyone needs to put their shoulder to the wheel."

THE TAKE-YOUR-LUMPS APPROACH

Bernstein's experience illustrates a fundamental fact of incentive compensation: sooner or later, you have to develop your own system. There are no blueprints, and there are no outside cures. You may discover some interesting features in other companies' programs. You may also find consultants who can help you think through your company's needs. But don't expect anyone to understand your company as well as you do.

"There's no substitute for sitting down, locking yourself in a room, and thinking about what's really important to your business," says Bernstein. "Otherwise you'll end up with a cookie-cutter approach that was designed for the company next door." So, in the end, most companies wind up developing their compensation programs the old-fashioned way—by doing it themselves.

still have to confront the issue of *long-term* incentives—the kinds of rewards that ensure employees stay focused on a company's objectives over the long haul. Those kinds of incentives can be just as important as the quarterly and annual ones, maybe more so, and the issues involved are no less thorny. Should you give people real stock, or stock options, or some sort of substitute, such as "phantom equity"? In a private company, how much information should you reveal? How should the value be determined? Who should you include in the plan? How often should you make awards, and at what level? Should you pay dividends? How can people cash out? The list goes on and on. In effect, you have to start all over again, deciding what kind of behavior you want to encourage, and why.

And, as they say on late-night television, THAT'S NOT ALL! You also have to be prepared to change your plan (or plans) at least every couple of years. Why? Because companies change, markets change, people change, objectives change. Even the best plans aren't good forever. Some need to be rejiggered every year—adjusting the performance criteria, including other people, and so on. From time to time, moreover, you may have to scrap the whole system and start again.

Consider Nicolet Instruments, which recently has been forced to restructure its program in response to a slowdown in its market. The original system rewarded managers according to the performance of individual product groups. It worked fine, says CEO Krauss, when the company was smaller, and growing at 25% to 30% a year. But now the growth has leveled off, and the old rules don't apply.

Incentive compensation takes an enormous amount of time and effort. It also requires that you think strategically about your business, that you provide significant rewards for performance, and that you be willing to share a lot of information with your employees. The systems that work best are the ones with clear objectives that people can understand and clear incentives that they can follow. If you can't provide those things, or don't want to, you might as well save yourself the trouble. Incentive compensation is not for you.

There's only one problem with that attitude. The evidence is overwhelming that a well-designed incentive system can have a major impact on a company's performance, giving it a new competitive edge. So if you don't set one up, you run the risk that your competitors will.

In fact, it could be that the company passing you on the right already has one. □

THE RELUCTANT ENTREPRENEURS

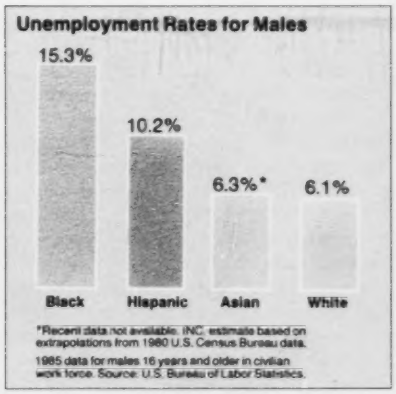
Are American blacks still stuck on the bottom rung of the economic ladder because so few start businesses of their own?

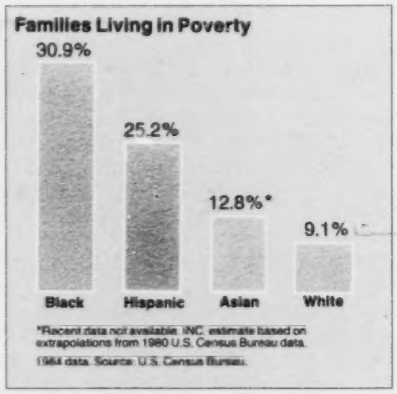
BY JOEL KOTKIN

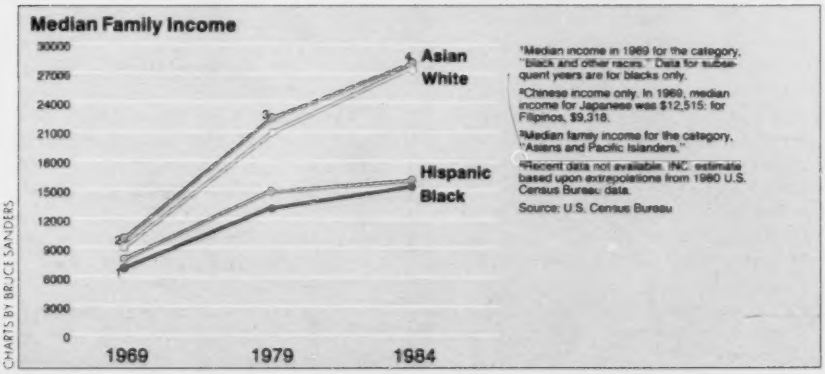
THERE IS NO MORE VEXING PROBlem for the American economy, or American democracy, than the worsening economic plight of American blacks. Blame white racism or the lack of black self-reliance. Point the finger at government programs that offer too much or too little. There is at least a germ of truth in each of these. But none of these highly charged explanations gets beyond the point of political rhetoric to the more fundamental dilemma: why is it that other minority groups have recently found their way into the great middle class while so many blacks still find themselves at or near the bottom rung of the economic ladder?

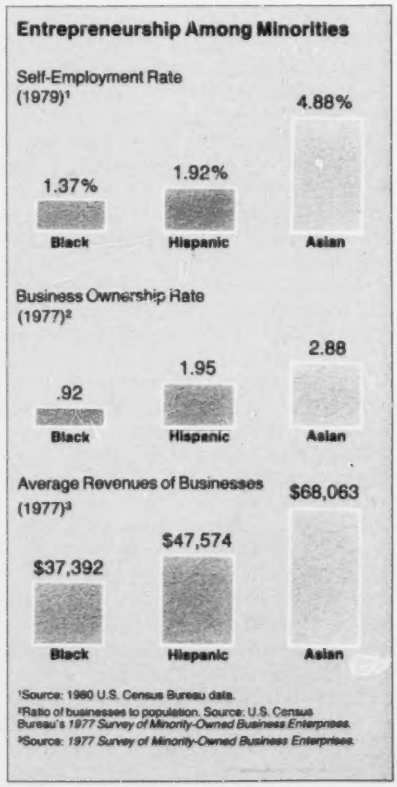
The accompanying charts begin to define the problem. In 1980, the Census Bureau found that median black family income was only 61% of white median family income—where it has been, roughly, since the mid-1960s. And since 1980, things have only gotten worse. Compare that with Hispanics, the next largest American ethnic group, whose income has been climbing steadily over the past decade and is now about 70% that of whites; or Asian-Americans, who have long since stepped ahead of whites. Statistics on unemployment, poverty, or welfare dependency all support the same general conclusion: that black America is falling even further behind.

It would be more comfortable to ignore these statistics and focus more positively on the growing black middle class. But even among these success stories there is something distinctive and revealing about the black experience—namely, the relative lack of black entrepreneurship. For Asian- and Hispanic-Americans, as with the Jews and Greeks and Italians before them, the favored path to upward mobility has lain in the starting of small, independent businesses. For blacks, by contrast, mobility has been defined quite differently—in terms of education at universities and professional schools, employment in large corporations or government bureaucracies, or celebrity


Unemployment Rates for Males
15.3%
10.2%
6.3%*
6.1%
Black
Hispanic
Asian
White
*Recent data not available. INC. estimate based on extrapolations from 1980 U.S. Census Bureau data.
1985 data for males 16 years and older in civilian work force. Source: U.S. Bureau of Labor Statistics.



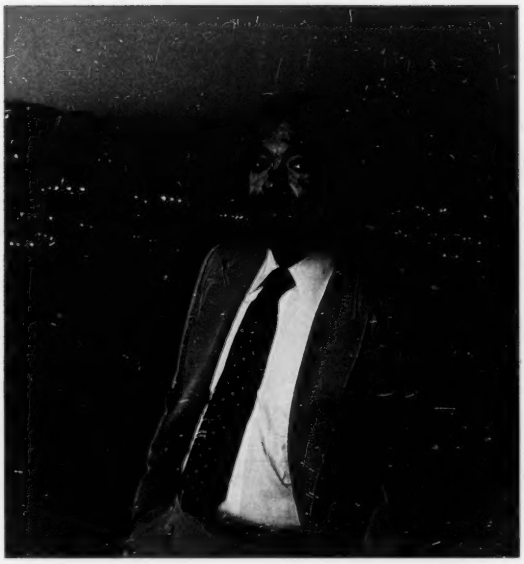




CHARTS BY BRUCE SANDERS

"Blacks haven't wanted to venture out on their own. They have relied on other people to make opportunities. They don't realize it doesn't kill your soul to be a capitalist."

BONDIE GAMBRELL, REAL ESTATE DEVELOPER, LOS ANGELES



in sports and entertainment. And perhaps more than any other factor, this absence of a black entrepreneurial tradition explains why the advances of some have not led to the advancement of many.

"You can talk about the other problems of our community, but the real cause is that we have failed to get into business," says Tony Brown, who hosts a popular series for public television. "We have to do something to shore up our economic institutions, to generate jobs *within* the community. When we take care of that, the other stuff—the family problems, crime, our political needs—will start taking care of itself."

The Census Bureau surveys minority business ownership only once every five years, so the most recent data available are a bit stale. But they show that while black entrepreneurship has been on the rise, it has been at a pace slower than other minorities. From 1972 to 1977, for example, the number of black-owned businesses rose 23%, but during the same period, Hispanics and Asians doubled their number of enterprises. A private study based on 1977 data reported that blacks owned about nine enterprises per 1,000 population—a rate about half that of Hispanics and a third that of Asians. Rates of self-employment, as reported in the 1980 Census, also reflected the same relative position.

Even in such fields as franchising, which has been the target of heavy lobbying and exhortation by such groups as Jesse Jackson's Operation PUSH, blacks are now falling behind other minorities. In 1973, blacks owned more restaurant franchises than either Hispanics or Asians, but by 1984 it was just the reverse. In fact, the number of Asian-owned franchises grew at a rate of about four times that of blacks.

In Los Angeles, where I live, you get a sense of these trends simply walking through the city's ethnic neighborhoods. Hispanic East Los Angeles, Chinese Monterey Park, and Koreatown, on the edge of downtown, are all bustling with new and growing businesses, both retail and manufacturing. There is noise and congestion; signs in a potpourri of languages compete for your attention. By comparison, black sections of Watts and South-Central L.A. convey an attitude of abandonment. Many of the storefronts are vacant. The manufacturing firms that survive employ Asians and Hispanics. The commercial life consists of little more than liquor stores, franchise restaurants, and bars—and, increasingly, even these are falling under ownership by Asians and other outsiders.

"Blacks have not had the mentality to do what the Koreans and Hispanics are doing," says Bondie Gambrell, a black real estate investor and developer in Los Angeles. "They haven't wanted to venture out on their own. They have relied on others to make opportunities. They don't realize it doesn't kill your soul to be a capitalist."

Robert A. Hill is a black historian at the University of California at Los Angeles and, like many who have studied the black experience in America, he traces the lack of an entrepreneurial tradition to African origins and the brutality of the American system of slavery. Africa, Hill points out, is a more communitarian society, where notions of private property have never been so entrenched as in Europe or North America. "The culture of capitalism is just not part of our African heritage," he maintains.

Certainly slavery and its progeny, the sharecropper system, did nothing to foster confidence, independence, or a capitalist inclination among Afro-Americans. Before slavery and after, white landowners considered that the proper way to treat the black was, in the words of one slave owner, to "create in him a habit of perfect dependence. . . ." And it was a system that proved to be enormously successful and enduring. Here is a race of people who for generations, both before and after Emancipation, were denied freedom of movement, education, and even a rudimentary familiarity with the free market—to say nothing of credit, legal status, or safety from lynch mobs. That their descendants have not taken naturally to entrepreneurship should hardly come as a big surprise.

Despite that, there were black entrepreneurs going back even before Emancipation. Among the country's half-million "free persons of color" were a considerable number of artisans, professionals, and owners of businesses—nearly 85% of the freed black community in New Orleans, according to one account. In the years after Emancipation, these families became the basis of a black merchant class in cities north and south, and it was through such enterprises as theirs that black income in the last third of the nineteenth century grew faster than that of whites.

By the turn of the century, in fact, there was something of a golden age of black enterprise in America. From his National Negro Business League, Booker T. Washington exhorted fellow blacks to "uplift" themselves by striking out on their own. And from the pulpit, ministers like Harlem's Adam Clayton Powell Sr. urged aspiring congregants into business on a bigger scale, reminding them, as reported in the Harlem newspaper *Age*, that "no race can ever be rich by saving its money." But there were limits as to how far black enterprise could go. North and South, by law or by tradition, black businesses were forced to operate within the narrow limits of an all-black economy.

At about the same time, a new group of blacks arrived on American shores. Unlike native American blacks, those West Indians who came to this country came by choice. And they came to make money. Many hailed from urban rather than rural backgrounds, which gave them greater familiarity with commerce. And even those from rural areas were more entrepreneurially inclined. Economist Thomas Sowell of the Hoover Institution at Stanford University, perhaps the best known of the conservative black intellectuals, points out that while the American slave remained completely under the control of his white master, West Indian slaves were allowed to tend their own small private plots and sell their surplus in the marketplace.

As a result of these differences in background, West Indians showed a remarkable success in business. By 1901, for example, West Indians owned 20% of Manhattan's black enterprises, twice their percentage in the population. Among the larger were Verbena Perfumery Co., which exported to Central America and the West Indies; and Thomas & Thomas, which imported cocoa and spices from the islands. As with the immigrant groups that preceded them to

PHOTOGRAPHS BY A. J. BERNSTEIN

New York City, these blacks were not shy about their connections to the "old country." And as with the Asian and Hispanic immigrants today, entire families pitched in to run these proudly ethnic businesses, keeping labor costs low and ensuring that the instinct for enterprise would be passed on to the next generation. Several families would sometimes get together, pool their capital in networks known as *susu*, and launch new enterprises. Such virtues as thrift and hard work were part of the West Indian ethos, and leaders such as Jamaican-born Marcus Garvey found willing listeners for their gospel of separatism and self-reliance.

Even today, Robert Maynard, editor and president of *The Tribune*, in Oakland, Calif., recalls how the "Barbadian network" helped his father build a small trucking company in New York City during the 1920s—a company whose profits provided Maynard with his ticket to a successful career in journalism. West Indians, he concedes, started with a different perspective from blacks born in America. "There's something about the immigrant experience that's different," he says. "There's a communal business spirit—something that's outside the experience of most Afro-Americans."

Like Maynard, the sons and daughters of these West Indian immigrants have come to play a disproportionately influential role in black America, initially in business, but over subsequent generations in politics and the professions as well. Census data from 1980 show Jamaicans, for example, with rates of self-employment nearly 60% higher than other blacks. And the median income of all West Indian black families now exceeds that of American whites.

The West Indian experience is the best indication that it is historic and cultural factors, not skin color, that best explain the disinclination toward business among so much of black America—a disinclination that borders on conviction.

Ask Los Angeles businessman Alonzo Wallette. Wallette recalls that a restaurant founded by his great-uncle in Shreveport, La., had become the city's most successful black enterprise by the time his father and some cousins had taken it over during the 1940s. Although whites could not legally sit at tables at the Freeman & Harris Café, the establishment enjoyed a heavy phone-in-and-delivery business from those whites whose desire for spicy Louisiana seafood was stronger than their racial prejudices. Yet this success, recalls Wallette, did not earn a position of honor for his family within the black community. As had been the case since Emancipation, it was the ministers, teachers, and other professionals who defined the black elite.

"My father was never considered as important as the so-called black role models, even though he could buy and sell all of them," recalls Wallette, who now runs his own small defense-electronics firm in Inglewood, Calif. "The black community never quite got the point that business is the name of the game."

This relative lack of prominence for black entrepreneurs also came to be reflected, years later, in the civil rights struggle of the 1950s and '60s. Ministers, lawyers, and other professionals dominated the movement, and their emphasis reflected the aspiration of a black middle class that wanted to break down the barriers to the white establishment. Less emphasis was given to building a strong and separate black economy that would create its own wealth, its own jobs, its own prosperity. The goal was status—legal, social, and even economic—not money. As Atlanta Mayor Andrew Young, a former aide to Martin Luther King Jr., remembers it, "We were almost taught that there was something wrong with being rich."

Eventually, the civil rights movement opened the doors of opportunity for thousands of blacks. Many went on to college educations. And most responded to the preferences of the prevailing black culture by choosing careers in government, the professions, or the corporate side of American business. In 1980, more than half of all black professionals and managers were working for the government—a percentage well above that for the white population. The number of black managers in big corporations grew steadily.

"A lot of my black classmates at Harvard felt they were getting the opportunity that we never had before," recalls E. R. Mitchell Jr., president of a family-owned construction firm in Atlanta. "The idea was to be conservative. You didn't want to blow that chance."

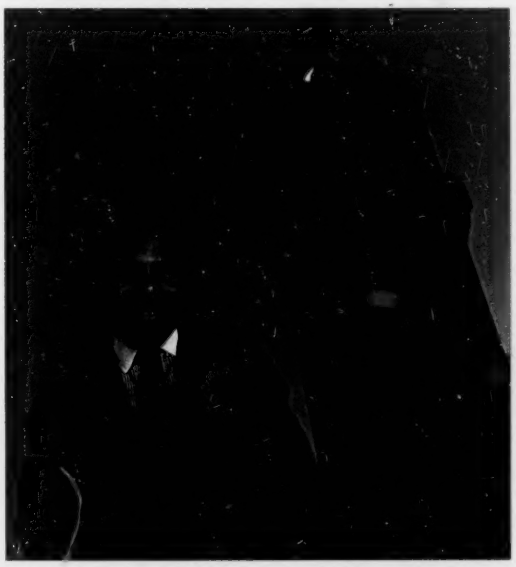
Playing it safe meant starting careers, not businesses. And what followed was something of a brain drain within the black business community. Where once the top accounting, legal, and business talent stayed within the community, now the best and the brightest went on to better things in the white world.

"After integration, a lot of blacks got into the system and made it," says Atlanta florist Alice Bussey, past president of the predominantly black Atlanta Business League. "But now they have become so individualized that they forget they are supposed to be active in the community. That's why we're not as cohesive as we need to be."

At the same time as it was being cut off from much of its potential brainpower, black business also suffered the loss of its traditional base of black customers, especially in the retail sector. Shops that survived the humiliations of Jim Crow died like flies during the 1970s as blacks discovered the wonders of franchised foods, Safeway markets, and chain convenience stores.

"When I was growing up, we had black laundromats and drugstores," recalls Oakland accountant Herman Morris of his boyhood in Little Rock. "But integration changed all that. All of a sudden—hallelujah—you could work and shop with whites. People turned away from black economic institutions because that was a way of getting away from the past." That was true of all blacks to some degree, but middle-class blacks especially. "It was like an insurmountable trade barrier had dissolved overnight," explains Robert Suggs, a researcher at The Joint Center for Political Studies in Washington, D.C. "The traditional black business almost immediately lost its most affluent clientele."

This turning away of customers severely undermined the market position of black entrepreneurs. According to television personality Tony Brown, from 1969 to 1984 the proportion of black income spent in black-owned businesses dropped from 13.5% to only 7%. Black banks and insur-



"There's something about the immigrant experience of West Indians that's different. There's a communal business spirit—something that's outside the experience of most Afro-Americans."

ROBERT MAYNARD, EDITOR OF *THE TRIBUNE*, OAKLAND

ance companies, once pillars of the community's economy, were sold or folded. Even such traditional bastions of black business as hair-care products have watched as corporations like Revlon Inc. and Alberto-Culver Co. have increased their share of the black market.

In Columbus, Ohio, for example, Singletary Plaza Mart, the nation's largest black-owned "superstore," went out of business last year due to a lack of community patronage. Although blacks in Columbus spend $2.5 million each week on food, they couldn't be convinced to spend less than a tenth of it, or $200,000, to keep Singletary afloat.

And outside of St. Louis, in predominantly black University City, Sammy Kelley has similar complaints. Two years ago, Kelley left his job as assistant manager of an auto-parts store to open his own auto-parts shop. To finance the start-up, he invested $15,000 and put his house up as collateral for a $60,000 Small Business Administration loan. At first, things seemed to be working out, with sales averaging $13,000 a month. But since two white-owned stores opened nearby, sales have dipped below $9,000—not enough to break even. When he asked a former black customer why he now shopped at the white-owned Auto Shack, the customer said that he wanted to "help out the new guy."

Other ethnic groups tend to be more loyal to merchants of their own kind. Tony Brown refers to a San Francisco study that found that money in the Chinese community circulates there five or six times before leaving the ethnic enclave. The figure is four or five times for Jews. With blacks, money earned in the community usually leaves within minutes. It's no wonder, then, that among black entrepreneurs surveyed by *Black Enterprise* magazine, some 70% consider lack of community support among their greatest problems.

"The Chinese are helping the Chinese, the Haitians help the Haitians, Cubans help Cubans, but blacks are helping everyone else," complains Brown. "We have been conducting the most successful business boycott in American history—against ourselves."

This erosion of traditional markets helps explain the relative lack of success among black businesses. From 1977 to 1982, according to the Census Bureau, the total receipts of the nation's black-owned businesses dropped in constant dollars by more than 9%. As a group, they generated virtually no new jobs. During the same period, the receipts of the rest of the economy jumped by more than 3.5%, while total employment was up by 8%.

Even the best black-owned companies so far have failed to break into the elite. In a recent survey of nearly 600 chief executive officers from the INC. 500 list of the fastest-growing private companies in America, 10 were Asian, 11 were Hispanic, and only 2 were black. Equally revealing, the *Black Enterprise* 100, a ranking of the nation's top black-owned firms, lists only 4 companies with 1985 sales above $100 million. In contrast, the top 15 of the nation's largest Hispanic-owned firms had 1985 sales above the $100-million mark.

"When it comes to business, we're barely out of chains," observes Oakland accountant Herman Morris. "There's a tremendous lack of sophistication in our business community, lack of infrastructure. In the six-mile race with everyone else, we're starting out 6,000 feet behind."

Perhaps no American city so epitomizes the problems faced by blacks and black business as Miami. Miami's is a booming economy in a booming region. And as in so many cities, Miami blacks have had to watch as other, newer minority groups have come along and passed them by on the road to economic security and prosperity.

Back in 1957, when Sonny Wright arrived in Miami, business was lively and vibrant in such black inner-city neighborhoods as Overtown and Liberty City. Independent laundries, restaurants, nightclubs, hotels—many of them black-owned—flourished along the main streets of the steamy resort city. "We had a thriving little business community," Wright remembers. "The black entertainers like Sammy Davis Jr. and Nat "King" Cole stayed in our hotels. Blacks bought from blacks."

Wright himself started out as a laborer, washing cars and doing odd jobs. Over time, he met a number of local businessmen, both black and Jewish, who soon helped him start his own restaurant. "I worked my ass off," Wright remembers. "But I learned a lot. I met the meat man, the bread man, the jukebox man. They became my advisers. I was getting an education in business administration." Eventually, this education paid off. After attending real estate school, Wright left the restaurant business and started his own realty firm. And by the mid-1970s, he was boasting more than $5 million a year in sales.

Now all that has changed. "Ever since integration, everything is gone," says Wright. "The smart guys went to work for the government or moved to the suburbs. Nobody stayed around. Nobody created jobs in the community. Integration set everything downhill for black business in this town."

Today, where once Sonny Wright sat at the lunch counter chatting with his fellow black businessmen, there are only deserted storefronts and empty lots. As the deterioration of the 1970s gave way to the riots of the early '80s, Wright's inner-city real estate trade took a turn for the worse. Sales today, he says, are "a helluva lot less" than what they were a decade ago.

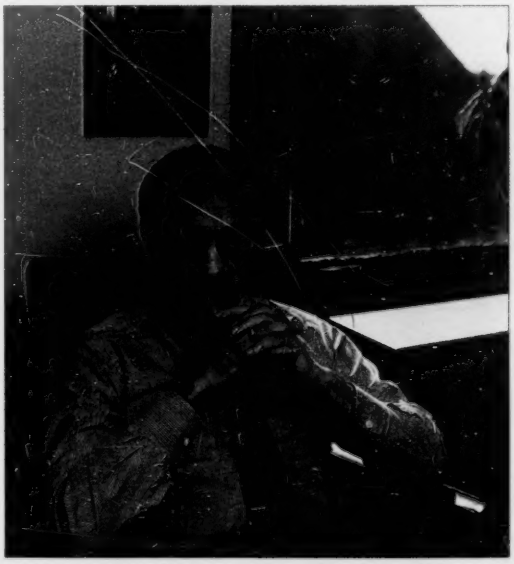
In contrast, the ascendancy of Miami's Cuban community has become the kind of story that renews the great American dream. And, not surprisingly, it is a tale that evokes both envy and resentment among Miami blacks.

Miami's Hispanics are twice as likely to start businesses as Miami's blacks. While most of these are modest businesses, some are more modest than others. One study reported that the average Hispanic company in Miami boasts sales of $84,000, the average black business only $45,000. And you sense the shifting balance at every street corner. In 1960, blacks owned 25% of the service stations in Dade County, for example, while Hispanics owned only 12%. By 1979, the figures were 9% for blacks and 48% for Hispanics.

This entrepreneurial prowess has translated directly into a higher standard of living, not just for those who own businesses, but for the Hispanic community in general.

"The Chinese are helping the Chinese, Cubans help Cubans, but blacks are helping everyone else. We have been conducting the most successful business boycott in American history—against ourselves."

TONY BROWN,
PUBLIC TV HOST,
NEW YORK CITY



In 1979, median family income among Miami's Hispanic community was $16,331, or 80% of the median family income for whites. Among black families, it was $12,710, or 63% of that for whites. Today, black unemployment is near 9%, while the rate for Hispanics is about 6%.

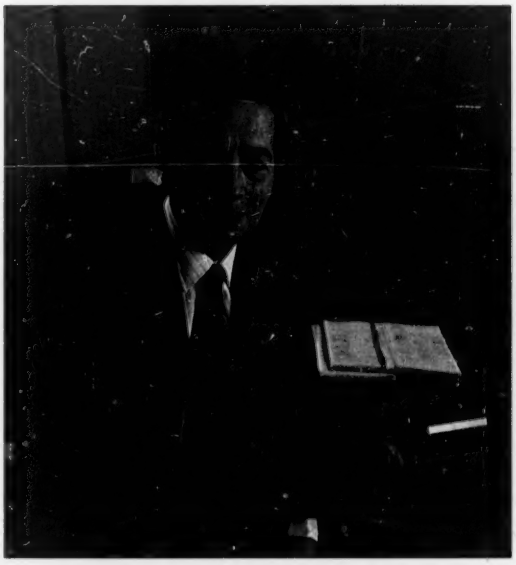
"The black leadership sees success not in an entrepreneurial context," says Tim Mescon, a business school professor at the University of Miami who has conducted studies on both black and Cuban businesses in the Greater Miami area. "It's like their whole development is missing a chapter, the one on achieving equality through their own business development. They still see success as being a teacher or physician, of fitting into the white world that way. Cubans try to make it by working together to build economic strength. And it's worked marvelously."

The difference is perhaps most visible in the area of banking. Blacks have only one small and still struggling bank in South Florida—Peoples National Bank of Commerce—which was purchased by Sonny Wright and others in 1983 only after the white owner of the Miami Dolphins agreed to guarantee the financing. By contrast, Miami's Hispanics control 30 banks, including the Cuban-owned Republic National Bank of Miami, which has grown from a few million dollars in assets a generation ago to more than $800 million today. That's more than the combined assets of the 9 largest black-owned banks in the entire United States.

"When the Cubans came over, they didn't have any inside track," notes an admiring Arthur Hill, president of Peoples National Bank of Commerce. "The whites didn't trust them any more than they trusted us. The difference was that the Cubans took matters in their own hands. They knew each other and took risks for each other. They went out and created their own economy."

Of course, the Cubans who came to Miami were self-selected risk-takers, many with personal savings and entrepreneurial experience to draw upon. But there is no doubt that they pooled their resources effectively and, through their banks, helped multiply those advantages a thousand times over. The bustling garment factories, coffee shops, trading firms, *bodegas* (grocery stores), and gas stations of Miami's Little Havana and Hialeah stand in sharp contrast to the economic torpor of Liberty City and Overtown. These are businesses, by and large, that got their start with Cuban money, and now rely heavily on Cuban customers.

"If a Cuban had a cleaning shop and we knew him, we lent him money," explains Republic National's chairman, Luis Botifoll. "And people in the community bought from that store because the owner was Cuban. Blacks have to do the same. They have to help themselves, their own people. You have to create that sense that there's no reason to go to McDonald's. When you go to your own, you create wealth. Then you have the power."



"Blacks have to help themselves, their own people. You have to create that sense that there's no reason to go to McDonald's. When you go to your own, you create wealth. Then you have the power."

LUIS BOTIFOLL, CHAIRMAN, REPUBLIC NATIONAL BANK, MIAMI

Judged by its purely political power, of course, black America has enjoyed progress far greater than any major minority group. Since 1970, the number of black congressmen has doubled to 20, and the number of black mayors is approaching 300. Blacks now control the top offices in Detroit, Newark, Los Angeles, Chicago, Philadelphia, and New Orleans. Not since the Irish has an ethnic group shown such political muscle.

Yet these gains do not seem to have translated easily into economic gains. "When blacks took power, everyone thought the economy would change overnight," says Oakland real estate developer James Johnson, himself a former city manager of Compton, a predominantly black city south of Los Angeles. "But government can only provide leads and open doors. Government cannot create entrepreneurs. It can't turn a ghetto into a nice neighborhood."

The limits of political clout can perhaps best be seen in Atlanta, a city that Southern blacks, like Miami-Dade Chamber of Commerce president Kelsey Dorsett, call "the Black Mecca." Atlanta has long boasted a strong black professional and business class, and, with Morehouse College and Spelman College, has been home to some of the best black colleges in the nation. The city has also served as the training ground for a generation of civil rights leaders, starting with Martin Luther King Jr.

In 1973, Atlanta's black elite gained control of city hall with the election of Mayor Maynard Jackson, and went about, in a systematic way, trying to leverage political power into economic power. Shortly after taking office, for example, Mayor Jackson threatened to hold up a $400-million airport-development project until whites agreed to allow blacks 25% of the airport-design-and-construction contracts. Today, under Jackson's successor, Andrew Young, black firms are supposed to receive 35% of the city contracts. This aggressive strategy has resulted in a major shift in city spending: since 1973, contracts to minority businesses have grown from $41,000 to $20 million. And it has certainly meant a windfall for a number of black construction firms, business service companies, and, through airport concessions, black retailers as well. But there is precious little evidence that it has spawned a new era of entrepreneurship among Atlanta's blacks, or even significantly improved the lot of Atlanta's poor.

Consider, for example, that overall rates of black entrepreneurship in Atlanta are no greater than in such cities as Houston, Baltimore, and Dallas, where city halls are still very white. And in Atlanta, even those black entrepreneurs who have benefited from the city's tough minority participation policies complain that, in dealing with white companies on nongovernment business matters, they are still treated like second-class companies. "I go to the trade shows and start handing out my cards to 75 or 100 potential clients," says black contractor E. R. Mitchell Jr. "I follow up with them. But nothing ever happens."

Fourteen years of political power have also done little to raise the relative position of Atlanta's black underclass. The income differential between the city's black and white families remains much as it was. And the city's rate of black poverty is no better than the national average. Furthermore, much of the economic growth in Atlanta has now shifted to the suburbs, beyond the range of most inner-city workers and beyond the reach of black political power. "Blacks might control the city," observes Cornell McBride, president of M&M

"TAKING CARE OF OUR OWN"

Black networks spring up to help the "best and the brightest" start new firms and lure black customers to black businesses.

For most of his working life, Dwayne Wynn has seen his city move forward—and his own people left behind. But today, Wynn, an insurance systems administrator and owner of an import business, believes that things are changing. Having seen the growing power and affluence of the highly cohesive Cuban business community, Wynn believes Miami's blacks are finally beginning to emulate their Hispanic neighbors by building a strong business network among black entrepreneurs and professionals.

"For years, there's been a void in our community," says Wynn, who now heads The Network Inc., which has 800 members. "This way, we can start to make the connections between ourselves that haven't been made in the past."

There are other such efforts. The American Health and Beauty Aids Institute is made up of 22 minority-owned companies that give research advice to black businesses in an industry that has traditionally had a strong black presence. And in New York City, the Coalition of Black Professional Organizations seeks to create a critical mass of economic clout within the black business community—its own old-boy network. "We know that the ability to cut business deals is based on who you know," says attorney Darrell Gay, chairman of the Coalition. "It's the way it works for the *Fortune* 500 executives." There are similar groups in Washington, D.C., and Atlanta.

Miami executive Dwayne Wynn
Creating an old-boy network for blacks

Perhaps one positive sign of change has been the number of black managers and professionals from big corporations showing up at black network meetings and "business card exchanges." Many admit now that they feel their opportunities are limited within the confines of these largely white institutions. Indeed, a recent National Urban League study found that only 13% of black corporate managers feel they have a "high" potential for promotion within their firms.

"The game is rapidly changing, from working within the system at major companies toward ownership and creating enterprises that create wealth, jobs, and real power," says an optimistic Arthur J. Hill, president of Miami's minority-owned Peoples National Bank of Commerce. "The young technocrats are beginning to understand how real wealth is accumulated in this country."

Black enterprise needs entrepreneurs—that's one problem. It also needs customers. And in New York City, TV commentator Tony Brown is working on that, too. His "Buy Freedom" campaign aims to persuade black consumers to spend their dollars on companies that are black-owned or employ large numbers of black workers. Brown points out that if American blacks were a separate nation, theirs would be the ninth largest economy in the world. If they would shift a fraction of their $200 billion in spending each year to black enterprise, the results, he argues, would be spectacular.

"This is the essence of the American way," argues Brown. "It's worked for the Jews, the Cubans, and the Asians. You can't keep waiting around, blaming white people and racism for all your problems. If you wait around for the last racist to die, you'll be waiting around an awful long time. And I think we've already waited long enough."

Products Co., a maker of ethnic hair-care products and one of Atlanta's largest black manufacturing firms, "but they can't stop whites from moving the industry."

Atlanta is not unique. Blacks in Oakland find themselves in control of city hall, and even of the city's major newspaper. But political progress has not been matched by economic progress. The mayor and the newspaper have not persuaded blacks to deposit their money in the Bank of Oakland, where the majority of stock is minority owned, rather than the giant Bank of America. Nor have they been very successful in luring bright young black professionals away from Clorox Co. or Safeway Stores Inc. so that they could start their own electronics firms downtown. Developer Jim Johnson despairs that while Oakland blacks may view politics as a collective enterprise, they still see business as an "every man for himself" proposition. Economic growth in Oakland today lags far behind that of its surrounding white suburbs.

Approximately 400 miles to the south, in Los Angeles, which elected a black mayor 14 years ago and boasts the single largest concentration of black businesses, blacks still lack economic clout. One good indication is the absence of even a single black-owned commercial bank. Back in 1982, Alonzo Wallette tried to start one, figuring that surely there was $3.5 million to be raised from the scores of wealthy black entertainers and athletes who call Los Angeles their home. But Wallette rarely got past the celebrities' agents, and he was forced to abandon the effort, bitterly disappointed.

"It's still the damn slave mentality," complains developer Bondie Gambrell, who helped Wallette in the search for black capital. "It's the house nigger and the field nigger. Those that have don't want to let the guys out in the field in on the goodies. Everyone seems to want to be the only black allowed in. They don't understand that there's a big enough world out there for everyone."

Gambrell casts an admiring eye at Los Angeles County's Asian community—about half the size of the black community—which today controls some 30 commercial banks in and around the city. The Asians have used their money collectively to start and expand businesses, educate their youth, and even send some of what's left over to relatives abroad. Korean-Americans, for example, who represent only 1% of the population, own nearly 5% of all retail businesses in the county. And more recently, Koreans have begun buying up businesses and real estate in such traditionally black areas as Watts and South-Central Los Angeles. The move has spawned new racial tension in the city. Some blacks have even begun to boycott Asian-owned businesses as a sort of silent protest against the aggressive "foreign" businesspeople in their midst.

"Blacks just don't do what the Koreans do," says Gambrell as he looks wistfully over the city from his posh hillside home. "They band together and raise capital. They work hard and move into our neighborhoods. But it's not their fault. They've figured out that the real color of freedom is green." □

Research assistance for this article was provided by Hope Tompkins.